In its NPRM, the Commission states that LFAs (and sharing amounts) implemented in one year relate to productivity performance in a prior year and that unless the LFA (sharing amount) add-back occurs, the relationship between rate of return and productivity growth for the current year will be hidden.[19] The relationship between rate of return and productivity growth for the current year is <u>not</u> hidden when the LFA add-back is not made because the additional LFA-year. LFA rate increases should not be accounted for in the prior year unless the intent of the LFA rate increases is to recover prior period costs or guarantee a minimum rate of return for the prior period.

If the Commission is desirous of using earnings-related information to analyze LEC productivity, it can do so. However such analysis must be done outside of the earnings calculations used to expressly calculate sharing and LFA amounts.

B. Swings in Earnings are Not Artificial, They're Real

There is nothing artificial about the swings in earnings that the Commission indicates it may seek to avoid by proposing the LFA add-back. In its NPRM, the Commission states that the earnings swings occur because the unadjusted rate of return effectively double-counts the amount of the into effect in any year in which LEC prior-period earnings fall below 10.25 percent. In the Commission's analysis the LFA-related rate increases kick in every other year. Even though LEC costs have not changed from one period to the next in Scenario 2, if it were not for the periodic LFA induced rate increases, LEC earnings would remain constant when their costs remain constant.

In the example provided by the Commission, the LEC whose cost remained constant would earn 9.25 percent in each and every year were it not for the additional revenues periodically provided by LFA rate increases. In those years when the LFA rate increases go into effect, the LEC earns 10.25 percent. This is exactly what the LFA is intended to do. In any given year in which LECs do not earn at least a 10.25 percent, they are allowed to increase their rates in the following year to a level which, using the prior year as a baseline, would provide LECs with the opportunity to earn at the lower end of the earnings range (10.25 percent). This is how the lower formula backstop-adjustment under price cap regulation is suppose to work.

VIII. Conclusion

MCI has demonstrated that the LFA add-back in the calculation of rates of return is inappropriate and inconsistent with both rate of return and price cap regulation. MCI has also shown that the inclusion of an LFA add-back in the rate of return calculation is tantamount to retroactive ratemaking and effectively guarantees the LECs a minimum 10.25 percent rate of return under price cap regulation.

Moreover, MCI demonstrated that the LFA add-back unequivocally and permanently excludes revenues derived from LFA rate increases from ever being included in the calculation of base period earnings.

MCI therefore respectfully requests the Commission not to allow add-backs for LFAs when calculating rates of return

STATEMENT OF VERIFICATION

I have read the foregoing, and to the best of my knowledge, information, and belief there is good ground to support it, and that it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on August 2, 1993.

Randy R. Klaus (ARR)

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CERTIFICATE OF SERVICE

I, Carolyn McTaw do hereby certify that copies of the foregoing MCI petition were sent via first class mail, postage paid, to the following on this 2nd day of August 1993:

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